

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Soto Analyst: Jeff Garnier Bill Number: SB 401
Related Bills: See Legislative History Telephone: 845-5322 Amended Date 04/16/01
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Homeownership Tax Credit Act of 2001

SUMMARY

This bill would allow a "homeownership tax credit" in an unspecified amount to certain financial corporations for making qualified second mortgage loans.

SUMMARY OF AMENDMENT

The April 16, 2001, amendments made changes to the definitions of "neighborhood revitalization project area," "neighborhood revitalization project loan," and "qualified homeownership tax credit loan." The amendments also made numerous technical changes.

PURPOSE OF THE BILL

The author's staff has indicated the purpose of the bill is to encourage financial institutions to loan money to low-income individuals to enable such individuals to purchase homes.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill is effective for taxable years beginning on or after January 1, 2001. The credit would be operative for taxable years beginning on or after January 1, 2002.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to work with the author's office as the bill proceeds through the Legislature to resolve the concerns discussed below under "IMPLEMENTATION CONSIDERATIONS" and "TECHNICAL CONSIDERATIONS."

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

05/02/2001

ANALYSIS

FEDERAL/STATE LAW

Federal law provides for the exemption of interest earned on qualified mortgage revenue bonds (MRB) (Internal Revenue Code §143.) Numerous requirements and limitations are placed on MRBs, including a requirement that bond proceeds be used to fund first-time homebuyer's mortgages or make qualified home improvement loans, qualified rehabilitation loans, or loans for specified targeted areas (normally low income areas.) Limitations include maximums placed on the family income of the home purchaser and value of the home.

Existing state law allows a credit for interest income on loans used to finance qualified expenditures for farmworker housing. Existing state law also allows taxpayers that make loans to businesses within an Enterprise Zone to deduct net interest.

Existing federal law taxes interest on federal obligations (e.g., bonds issued by the federal government and certain federal agencies) and allows such interest to be included in the income base of a nondiscriminatory state tax. (For this purpose, the tax is nondiscriminatory if the tax imposed on the federal interest is not different than tax assessed on any other interest, including interest on state obligations.) Under existing state law, interest on state obligations (e.g., bonds issued by this State and political subdivisions of this State) and interest on federal obligations are exempt from personal and corporation income tax, but are included within the measure of the corporate franchise tax.

THIS BILL

Under the Bank & Corporation Tax Law (B&CTL), this bill would provide that CTAC would allocate a homeownership tax credit in an unspecified amount to qualified lenders that make qualified homeownership loans.

CTAC would allocate the credit, over a credit period of 10 years, based on bids for the value of the credit submitted by the lenders. Lenders with loans that are prepaid during a calendar year would be given priority for credit allocations in the succeeding calendar year. CTAC also would prescribe an applicable percentage to arrive at the credit amount for the year. The applicable percentage would yield, over the credit period, a present value of 100% of the allocated credit. The method used to discount the applicable percentage would be determined under IRC section 42(b)(2)(C), relating to the low-income housing credit applicable percentage. The homeownership tax credit loan could be sold or transferred during the credit period, and the party acquiring the loan would be allowed the remainder of the credit over the remaining credit period. If a qualified loan were repaid prior to the expiration of the credit period, the amount of the unexpired credit would no longer be available as a credit.

The bill also would appear to require CTAC to adopt a written "approved allocation plan" certified by an unspecified "Secretary." The plan would include the following:

- Selection criteria used to award the credit would be based on bids submitted by lenders, and the priority given to specified lenders.
- An assurance that CTAC would not allocate more than 10% of the credit amount for a calendar year for neighborhood revitalization project loans.
- A procedure that CTAC would follow to monitor for noncompliance with the terms of this bill and to notify the Franchise Tax Board (FTB) of noncompliance.

CTAC would be required to submit to the FTB, in a manner agreed to by both parties, an annual report. The report would specify:

- The amount of the credit allocated to each qualified lender.
- The principal amount of the aggregate new qualified loans made during the year and the outstanding amount of the loans in the year for each qualified lender.
- The number of qualified loans made by a qualified lender during the year.

CTAC would be required to prescribe regulations as may be necessary or appropriate to administer this credit.

This bill would allow FTB, upon a finding of non-compliance, to revoke any qualified homeownership tax credit allocated by CTAC.

A "qualified lender" would meet all of the following requirements:

- Is an insured depository institution, an insured credit union, a community development financial institution, or a nonprofit community development corporation.
- Makes available pre-purchase homeownership counseling for mortgagors.
- Originates a minimum of 100 qualified homeownership tax credit loans during the one-year period beginning with the date the credit was allocated. The aggregate amount of loans made must not be less than the bid made by the lender to CTAC.

The bill contains numerous requirements and limitations on what constitutes a "qualified homeownership tax credit loan". They include limits on loan amounts, interest rate, amortization period, and amount of fees charged. Requirements and limitations are also placed on the borrower, such as the minimum down payment made and maximum family income level. A complete explanation of the requirements and limitations placed on qualified homeownership tax credit loans provided by this bill is attached as **Appendix I**. Appendix I also includes an explanation of "neighborhood revitalization project loan" and "neighborhood revitalization project area."

This bill also would provide that no portion of the unused business credit for any taxable year that is attributable to the homeownership tax credit may be carried back to a taxable year ending before the date of the enactment of this bill.

IMPLEMENTATION CONSIDERATIONS

The major implementation considerations are as follows:

- It is unclear if CTAC would set the applicable percentage at the beginning of the credit period or would set a new applicable percentage every year.
- It is unclear if the maximum credit CTAC can allocate every year is for a single taxpayer or the aggregate amount for all taxpayers or both.
- The terms “Secretary,” “reasonable,” and “residence” are not clearly defined.
- The bill does not contain any reporting requirements on the sale of homeownership tax credit loans to either a qualified or a non-qualified lender. Additionally, there are no time frames set for CTAC to provide lenders with the applicable percentages each year; if not provided in a timely manner, lenders would not be able to file timely returns.

TECHNICAL CONSIDERATIONS

There are numerous technical considerations, including cross referencing errors, that would best be corrected after the implementation considerations are addressed.

LEGISLATIVE HISTORY

SB 2198 (Soto) (2000) would have provided for the same credit. SB 2198 failed passage in the Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

Review of *Illinois*, *Michigan*, *New York*, and *Texas* laws found no comparable tax credits. These states were reviewed because of the similarities between California corporation tax laws and the tax laws of those states.

FISCAL IMPACT

Departmental Costs

Once the implementation considerations are resolved, this bill should not significantly impact the department’s cost.

Tax Revenue Estimate

As drafted, the aggregate annual amount of credits is unspecified. In 2001-02, revenue losses, if any, would be minor. Beginning in 2002-03, potential revenue losses from the proposed credit would likely start low and increase gradually each year.

If experience with the start-up of the Low-Income Housing Credit and the timing of actual revenue losses are representative of the proposed credit, the following pattern would apply. The low-income housing credit was enacted in 1987 with a \$35 million allocation limit annually. Actual revenue losses from applied credits started at a very low level, increasing gradually each year. A revenue loss amounting to one-half of the nominal allocation limit was reached after five years and five additional years before it reached the \$35 million level.

ARGUMENTS/POLICY CONCERNS

Federal law prohibits discriminatory state taxation of interest on federal obligations. This bill provides a credit to banks and financial corporations to encourage certain homeownership loans at interest rates that could be below market rates. This could be interpreted to discourage lenders to invest in federal obligations and, as a result, to discriminate against federal obligations in violation of federal law.

It is possible this bill would allow the credit for purchases of homes located outside of this state.

This bill would appear to allow the taxpayer to carry back the credit to a taxable year prior to the year the credit was earned. No other credit or deduction under California law is allowed to be carried back.

The tax credit does not contain a sunset date. Recently enacted credits contain sunset dates and generally are provided to allow periodic review by the Legislature.

LEGISLATIVE STAFF CONTACT

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"Qualified homeownership tax credit loan" would mean all of the following:

- A loan originated and funded by a qualified lender that is secured by a second lien on a residence.
- The proceeds of the loan are used exclusively to acquire a residence or to substantially improve the residence in connection with a neighborhood revitalization project.
- The principal amount of the loan is at least 18% of the purchase price of the residence and not more than 20% of the purchase price or \$40,000, whichever is less. In the case of a neighborhood revitalization project loan, the principal amount of the loan is not more than 20% of the appraised value or \$55,000, whichever is less. Prior to the April 16, 2001, amendments, the principal amount of a neighborhood revitalization project loan could not be less than 18% of the appraised value. Beginning in 2002, these percentages and amounts would be adjusted for inflation based on the housing price index as published by the Federal Housing Finance Board.
- The loan cannot be amortized over more than a 30-year period. However, CTAC may set the amortization period below 30 years. The loan may be a balloon payment loan if the following conditions are met:
 - ? The loan is for a period of 25 years and no payment is due until the earlier of the end of the period or the date the residence is disposed of. Payment also could be required if the mortgagor (borrower) receives any portion of the equity of the residence while refinancing any loan secured by the residence.
 - ? The loan does not prohibit early repayment of the loan.
 - ? The rate of interest on the balloon payment loan is zero.
- The proceeds of the loan could not be used to pay settlement or closing costs in excess of 4% of the purchase price or appraised value of the residence.
- The rate of interest on the loan could not exceed the greater of 3% or the amount that the prime interest rate, on the date the loan is originated, exceeds 5.5%.
- The origination fee paid in connection with the loan could not cause the aggregate amount of origination fees paid in connection with any loans securing the property to exceed 2% of the appraised value of the residence, or 1% of the appraised value of the residence in the case of a neighborhood revitalization project loan.
- The servicing fees associated with the loan would be allocated from interest payments on the loan.
- The residence that secures the loan is purchased by a mortgagor with a down payment not less than the lesser of 2% of the purchase price or \$2,500. Prior to the April 16, 2001, amendments, the down payment limitations also applied to loans for substantial improvements and the residence had to be a single-family residence.
- The mortgagor who is obtaining the loan would have to meet all of the following:
 - The mortgagor's family income for the year in which the mortgagor applies for the loan could not exceed 80% of the median gross income for the area where the residence is located, as determined by income requirements for MRBs.
 - The mortgagor's debt-to-income ratio, with respect to the residence securing the loan, or total debt-to-income ratio would not exceed guidelines set by the Federal Housing Administration or some lesser ratio determined by CTAC or the lender.
 - The mortgagor must attend pre-purchase homeownership counseling provided by the lender.

- The mortgagor has not held title on residential property within three years of the loan application.

A “neighborhood revitalization project loan” would mean a loan secured by a second lien on a residence within a neighborhood revitalization project area and used exclusively to substantially improve the residence. The April 16, 2001, amendments added the "exclusively" and residence location requirement.

This bill would define a “neighborhood revitalization project area” as a geographic area designated by a local government that is identified in comprehensive plans, ordinances, or other documents as a neighborhood, village, or similar geographic designation. Unless the local government’s jurisdiction covers a population of not more than 25,000, the neighborhood revitalization project area could not be the entire local jurisdiction. The area is one for which local government must have taken specific efforts to alleviate physical deterioration and stimulate investment. Additionally, the area's median household income level could not exceed 80% of the area's median income. The April 16, 2001, amendments added the 80% median income requirement.